

EXCEPTION



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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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IN THE MATTER OF THE COMPETITION IN  
THE PROVISION OF ELECTRIC SERVICES  
THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO. RE-00000C-94-165

CALPINE'S EXCEPTIONS TO  
FEBRUARY 5, 1999  
RECOMMENDATIONS OF THE  
HEARING OFFICER

Calpine Power Services ("Calpine") files these Exceptions to the February 5, 1999  
Recommended Orders of the Hearing Officer.

**STRANDED COST PROPOSED ORDER**

The "financial integrity" method does not explain adequately what is meant by "sufficient  
revenues to at least meet minimum financial ratios." These parameters should be established in  
advance. In it June 22, 1998 Decision No. 60977, the Commission interpreted this "financial  
integrity" as "avoiding default under current existing financial instruments during a transition period,  
or the Commission to otherwise provide an allocation of stranded costs responsibilities and risks  
between ratepayers and shareholders." Decision No. 60977 at 11. The Commission also required  
the Affected Utility file minimum financial ratios to maintain financial viability for 10 years. *Id.* at  
12. This criterion of minium financial ratios "to avoid default" should be added to the Stranded Cost  
Order.

**ELECTRIC COMPETITION RULEMAKING ORDER**

**"Stranded Cost" Definition Should Be Retained**

Arizona Public Service Company ("APS") has requested that the reference to "value" be  
deleted in the present Rule 1601(39) and substitute the term "net original cost." APS claims that  
this change merely allows for the possibility that post-1996 costs might be included in stranded  
cost. This is misleading and there is no definition of what is meant by "net original cost." Is  
depreciation deducted from the original cost? Is the past recovery of regulatory assets deducted

1 from the original cost?

2 APS's concern over post-1996 costs is also raised in its other recommendation that the  
3 following language be included: "Stranded Cost includes [o]ther transition and restructuring  
4 costs as approved by the Commission." APS suggests this subsection be added so as to be  
5 consistent with Decision No. 60977, but it failed to explain the purpose behind the Commissions'  
6 comment was for recovery of transition and restructuring costs associated with divestiture and  
7 the Commission wanted a fixed cutoff date.<sup>1</sup> The Rules already provide that "reasonable costs  
8 necessarily incurred by an Affected Utility to effectuate divestiture of its generation assets" and  
9 "reasonable employee severance and retaining costs necessitated by electric competition" may be  
10 recovered by the Affected Utility under Rule 1601(39)(b) & (c). Consequently, no change to the  
11 definition of Stranded Costs is necessary.

#### 12 **ESP Registration Process Should Be Implemented with a Shorter Time-Frame**

13 Electric Service Providers ("ESP") should be entitled to "register" with the Arizona  
14 Corporation Commission and then be subject to the Commission Rules and jurisdiction. Instead,  
15 these Proposed Rules attempt to place a "regulated blanket" over every aspect of the ESP's  
16 business, which go beyond consumer protection and protecting the public interest. Instead of  
17 moving towards open competition, these Proposed Rules will expand the bureaucracy of the  
18 Commission. A simplified process, requiring the completion of an application, is all that is  
19 required. No hearing should be required unless requested by an affected party. The ESP would  
20 be required to comply with the Electric Competition Rules and consumer protections.

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23 <sup>1</sup> "We believe there does need to be a reasonable cutoff period for stranded costs and the  
24 approval date of the Electric Competition Rules is a reasonable cutoff. While the Affected Utilities  
25 may have additional costs related to transactions in implementing electric competition, those costs,  
26 if reasonable, can be factored into the market price. For clarification, the following should be added  
27 after 'adoption of this Article': 'or after the adoption of this Article if approved by the Commission.'  
28 In addition, as stated above, the Rule should be clarified that additional costs may also be included  
in stranded costs, such as costs related to divestiture or to retaining of workers whose jobs are lost  
because of competition, and costs related to or resulting from divestiture." Decision 60977 at 13.

1       The overall time-frame for granting ESPs their Certificates of Convenience and Necessity  
2 should not exceed 180 days, with the administrative completeness review by Staff within 45 days  
3 and substantive review within 90 days. It is recommended that these dates be changed in  
4 Proposed Rule 1603.J. With the safeguards already in place in these Rules, expediting the  
5 process will lower the cost of doing business which will create low-cost services for the  
6 consumer.

7 **Competitive Bid Process Should be Required for Standard Offer Services**

8       Rule 1606.B has been changed. It deletes the competitive bid process and merely states  
9 that purchases be made "through the open market." Calpine urges that the previous provision be  
10 retained, which reads: "After January 1, 2001, power purchased by a Utility Distribution  
11 Company to serve Standard Offer customers, except purchases made through spot markets, shall  
12 be acquired through competitive bid."

13       A critical distinction occurs between a competitive bid process and the open market.  
14 After January 1, 2001, the generation assets of the Affected Utility must be transferred to a  
15 competitive affiliate of the Affected Utility's Utility Distribution Company or to a non-affiliate  
16 entity. The Utility Distribution Company could then purchase all of its generation from its  
17 competitive affiliate if no competitive bid process is required. By deleting the bid requirement,  
18 Rule 1606.B is meaningless since all generation will be purchased on the open market after  
19 January 1, 2001, even between a Utility Distribution Company and its generation affiliate.

20       Rule 1601.B should require bidding as the sole means of securing wholesale power  
21 supplies by the Utility Distribution Company. This condition brings economic efficiency, less  
22 risk in developing new capacity, and more public approval. The bidding program is a means for  
23 the Utility Distribution Company to entertain proposals from outside power producers, including  
24 the competitive affiliate of the Utility Distribution Company. The bidding program allows non-  
25 utilities -- customers that generate, independent power producers, co-generators, and so forth -- to  
26 sell power to the Utility Distribution Company. Economic theory dictates that a competitive bid  
27 program allows the Utility Distribution Company to select the best electricity provider at the best  
28

1 price. Consequently, customers of the Standard Offer Service would receive the greatest savings  
2 and economic gain.

3 A 1988 report from the National Regulatory Research Institute, the research arm of the  
4 National Association of Regulatory Utility Commissioners, recommended bidding programs in  
5 purchasing electricity.

6 Under the Energy Policy Act of 1992 ("EPAAct"), non-utility generators were granted the  
7 right to engage in "wholesale wheeling," whereby they could sell power to any utility using  
8 transmission lines, not just the local utility that was situated closest to them. In April 1996, to  
9 implement and extend further the pro-competitive benefits of EPAAct, FERC issued Order No.  
10 888 and No. 889; these orders provided more specific guidelines on how transmission lines are to  
11 be opened up to competitors on a non-discriminatory basis. These Orders require vertically  
12 integrated monopolistic utilities to offer access at a single-tariff comparable to what they would  
13 charge themselves for similar services. EPAAct and the latest FERC orders opened up the electric  
14 marketplace to all power providers under the open access philosophy of deregulation and  
15 competitive purchases. Calpine desires the ability to sell its power to Utility Distribution  
16 Companies for resale to their customers. The bid process will allow all generators to compete in  
17 the Standard Offer Service market so that all Arizona customers will benefit from electric  
18 deregulation.

19 Without mandatory divestiture of generation assets, the bid process is of even greater  
20 importance in creating a competitive environment. Although structural unbundling might be  
21 attempted with the formation of a competitive affiliate of an Utility Distribution Company, it will  
22 still result in a situation whereby "its kind of like borrowing from Mark to pay Dick or vice  
23 versa," to use a phrase from William Meek of the Arizona Investors Association.<sup>2</sup> In other  
24 words, the incentive of the parent company is to have its Utility Distribution Company purchase  
25 on "the open market" power from its own competitive generation affiliate, even though it may

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26  
27 <sup>2</sup> Direct Testimony of Walter W. Meek, *In the Matter of Arizona Public Service Company's*  
28 *Rate Reduction Agreement*, ACC Docket No. U-1345-95-491 (4/96) at 6.

1 not be the lowest price. Requiring a competitive bid for Standard Offer Service would prevent  
2 this from occurring.

### 3 **Filing of ESP Maximum Rates Is All That Should Be Required**

4        ESPs are required to provide "adequate supporting documentation for their proposed  
5 rates" and all rates approved by another jurisdiction, such as the Federal Energy Regulatory  
6 Commission, in Proposed Rule 1606.I. In a monopolistic environment, the Commission  
7 appropriately sets tariffs based upon cost of service. In a competitive environment, prices are  
8 negotiated based upon supply and demand and market forces. Although the Commission may  
9 have an interest in knowing what the maximum rate might be, it would be difficult for any ESP  
10 to set a rate in advance of the bilateral or multilateral negotiation with customers. If ESPs are  
11 required to disclose the cost basis of services prior to negotiation, it would discourage, if not  
12 preclude, the investment of offering competitive services. This is proprietary information, which  
13 is far different from a monopolistic situation where the utility has captive customers. Therefore,  
14 it is urged that Rule 1606.I be deleted. Under Proposed Rule 1612.B, ESPs are required to file  
15 their tariffs describing their services and maximum rates. That is all that is needed.

### 16 **Estimates of Unmitigated Stranded Cost Should be Submitted by March 19, 1999**

17        Rule 1607.C provides that each Affected Utility must file estimates of unmitigated  
18 Stranded Costs. In the subsequent section, the Affected Utility must file on or before March 19,  
19 1999 its distribution charges or other means of recovering unmitigated Stranded Costs. In order  
20 to make these two subsections consistent, the first sentence in Rule 1607.C should read: "The  
21 Affected Utility shall file estimates of unmitigated Stranded Costs on or before March 19, 1999."  
22 In order to assess the reasonableness of the distribution charges or other means of recovering  
23 unmitigated Stranded Costs, both the estimates and the means of recovery should be filed on or  
24 before March 19, 1999.

1 **Affiliate Transaction Review of Non- “Utility Distribution Companies” Are Unnecessary,**  
2 **Burdensome, and Anti-Competitive**

3 Rule 1617 includes a new provision. Electric service providers that might have an  
4 affiliate Utility Distribution Company in another jurisdiction would be subject to the affiliate  
5 rules in this Proposed Order. Purpose of the Affiliate Rule is to preclude cross-subsidization  
6 between an Arizona Utility Distribution Company (“UDC”) and its affiliate and collusion  
7 between an Arizona-regulated UDC activities and the UDC’s parent or affiliate.

8 The Proposed Order intends to expand the definition of a Utility Distribution Company  
9 for the purpose of extra jurisdictional review of affiliate relationships outside of Arizona. No  
10 harm could occur to Arizona customers if an out-of-state regulated utility or its affiliate desired  
11 to subsidize lower cost services in Arizona. If the out-of-state provider has higher costs as a  
12 result of subsidizing its regulated activities, Arizona consumers would not purchase those  
13 services if they are priced higher than other competitive services available to those consumers.  
14 This logic is consistent with how cross-subsidies are addressed in Rule 1617.A.8: no  
15 noncompetitive service rate may subsidize a Utility Distribution Company’s competitive electric  
16 affiliate, and not vice versa. Competitive affiliates of an Arizona Utility Distribution Company  
17 may subsidize the UDC so long as those services are not provided below marginal costs.

18 Furthermore, the out-of-state activity of any ESP affiliate is already subject to regulatory  
19 review in its home state. The only objective of this requirement is to increase the cost of entering  
20 the Arizona competitive market. This proposed change in the Rules is clearly anti-competitive.

21 **Technical Corrections**

22 “Electric Service Provider” definition in Rule 1601(14) should include the word  
23 “Services” after Competitive.

24 “Systems Benefits,” as set forth in the new definition Rule 1601(36), includes “market  
25 transformation” even though the commentary states that this reference will be deleted, on page  
26 10 of the Concise Explanatory Statement. The words “market transformation” should be deleted.

27 Rule 1608 pertains to systems benefits charges. In keeping with the practice of not  
28

1 repeating the definition in the body of the Rules, the last sentence in Subsection 1608.A should  
2 read: "The amount collected annually through the System Benefits charge shall be sufficient to  
3 fund the Affected Utilities' or Utility Distribution Companies' Commission-approved System  
4 Benefits ~~low income, consumer education, demand side management, environmental,~~  
5 ~~renewables, long-term public benefit research and development, nuclear fuel disposal and nuclear~~  
6 ~~power plant decommissioning programs and other programs that may be approved by the~~  
7 ~~Commission from time to time.~~

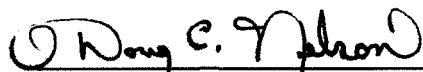
8 The last sentence in Rule 1616.C should include the word "Cooperative" instead of  
9 "Cooperatives."

#### 10 **Concluding Remarks**

11 Calpine urges that the competitive bid process be retained. Furthermore, it urges that the  
12 other Exceptions as described herein be adopted.

13 RESPECTFULLY submitted this 17<sup>th</sup> day of February, 1999.

14 DOUGLAS C. NELSON, P.C.

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16 

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21 **ORIGINAL and ten copies** of the foregoing  
22 filed this 17<sup>th</sup> day of February, 1999 to:

23 Docket Control  
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27 **COPIES** of the foregoing *hand-delivered*  
28 this 17<sup>th</sup> day of February, 1999 to:

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11 By *Vanessa Green*

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